

BEFORE THE POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

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Annual Compliance Report, 2013

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Docket No. ACR2013

**REPLY COMMENTS OF THE PARCEL SHIPPERS ASSOCIATION**

(February 14, 2014)

The Parcel Shippers Association (PSA) respectfully submits these reply comments in response to the initial comments of United Parcel Service (UPS) and the reply comments of the Association for Postal Commerce (PostCom).<sup>1</sup>

PSA finds itself in agreement with many of the policy principles that UPS advocates. For example, PSA agrees that as a Government-owned enterprise that enjoys a legal monopoly power with respect to many of the products and services it provides, “stronger controls, oversight, and limitations” are appropriate when it competes with the private sector.<sup>2</sup> PSA also agrees that it is important to have accurate estimates of the cost of Postal Service products and supports measures that will improve cost attribution regardless of whether they increase or decrease attribution levels.<sup>3</sup> PSA agrees, “[a] primary pillar of PAEA is transparency.”<sup>4</sup> PSA agrees with UPS

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<sup>1</sup> Initial Comments of United Parcel Service on Postal Service’s FY 2013 Annual Compliance Report, January 31, 2014 (UPS Comments); Reply Comments of the Association for Postal Commerce, February 14, 2014 (PostCom Comments).

<sup>2</sup> See UPS Comments at 10-11.

<sup>3</sup> See UPS Comments at 2-6.

<sup>4</sup> See UPS Comments at 9.

that competitive products should be charged for the equipment used in the provision of these services.<sup>5</sup>

It is useful that UPS raises its concerns. However, PSA, as explained below, disagrees with several of UPS' conclusions.

## **I. Cost "Allocation."**

UPS questions whether enough postal costs are being allocated to competitive products. It argues that the falling attribution levels over the last decade and a half are a sign of inaccurate costing. But the mere fact that attribution levels have declined does not prove that cost measurements are flawed. In this case, there is a reasonable explanation for the decline with respect to competitive products.

It is important to note that the PAEA is very specific about what constitutes "attributable costs": attributable costs are those that are determined through the use of causality-based costing methods.<sup>6</sup> The law contains not even a hint as to what is an appropriate level of attributable costs. So the task here is to examine why attribution levels are declining. It is not sufficient to simply suggest that more costs should be loaded on a particular group of products.

Declining attribution levels are natural consequences of declining volumes in general, and, in particular, of delivery costs becoming a larger proportion of total USPS costs over time. Fixed (institutional) costs constitute a larger share of delivery costs than they do of other large cost segments, such as mail processing and transportation. The increased importance of delivery costs, particularly as the number of delivery points increases, and the concomitant decline in attribution levels results primarily from positive developments. It reflects increased private sector participation in upstream mail processing and transportation activities, cost savings from automation and plant

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<sup>5</sup> See UPS Comments at 5-6.

<sup>6</sup> See 39 U.S.C. 36—(For purposes of this subchapter, the term 'costs attributable', as used with respect to a product, means the direct and indirect postal costs attributable to such product through reliably identified causal relationships.)

consolidations, and other economies put in place by Postal Service management. PSA supports this “last mile” trend that creates more private sector involvement in upstream mail processing and transportation.<sup>7</sup>

Another contributor to the reduction in attribution levels is the commencement in 2007 of statutorily required \$5+ billion per year retiree health insurance pre-funding payments. A large portion of these costs, but not all as UPS says,<sup>8</sup> are treated as institutional, i.e., they are not attributed. The costs for the “Annuitant Health Benefits & Earned CSRS Pensions” component group, which include the pre-funding payment, are treated as follows:

[T]he cost for this component group is treated much like workers compensation (18.3.4), also a labor-related cost, in that it is divided into a current-year amount that has the same variability and distribution as all labor costs and a prior-year amount that is institutional.<sup>9</sup>

In reply comments filed today reply comments filed today PostCom asserts that the “inability (or unwillingness) to attribute costs not only impairs the Postal Service’s ability to accurately price its products in response to market factors but, as UPS points out, it carries with it the risk that market dominant products will subsidize competitive products.”<sup>10</sup> As explained below, competitive products are providing an increasing share of institutional costs. Using Commission-approved costing methods, FY 2013 competitive product revenues exceeded attributable costs by \$3.9 billion. Even assuming that (1) there is some as yet unproposed method to better measure attributable costs, and (2) such method will result in higher attribution levels, it’s hard to imagine that competitive product attributable costs would be understated by nearly \$4 billion. PostCom, however, should worry that competitive products may be subsidizing market dominant ones, particularly those that according to Postal Service data and

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<sup>7</sup> “Th[e] last mile model has enabled the Postal Service, in partnership with Third-Party Providers (TPPs), to become competitive in the commercial ground parcel delivery market through the Parcel Select product. Better prices, better service, and increased volume resulted.” Parcel Shippers Association’s Comments On The Thought Leader Proposal, February 18, 2013.

<sup>8</sup> See UPS Comments at 2, fn. 1

<sup>9</sup> Summary Description of USPS Development of Costs by Segments and Components (Fiscal Year 2012), July 1, 2013 (“Summary Description”) at 18-6.

<sup>10</sup> PostCom Comments at 2.

Commission-approved methodology are losing hundreds of millions of dollars. Competitive products are profitable.

## **II. Transparency**

The UPS assertion that “the Postal Service’s practice of withholding almost all competitive product data from the public is improper”<sup>11</sup> seems a bit of an overstatement. So does its claim, particularly as it relates to costing methods, that “the public has no access to the information needed to analyze and determine whether or not substantive participation in a proceeding is warranted.”<sup>12</sup> USPS costing methods for competitive products are far from being an undisclosed black box.

First, when it comes to competitive products, requirements for disclosure need to be carefully balanced with the need to provide a level playing field on which the Postal Service and the private sector compete. This involves protecting commercial information that could give Postal Service competitors an unfair market advantage.

UPS is correct that the Postal Service does not publicly present attributable costs by cost segment and component for individual competitive products, but the Postal Service does publicly present substantial data allowing interested parties to evaluate the accuracy of Postal Service costing methods.

The Postal Service describes its costing methods, which must be approved by the Commission, in the Summary Description filed annually with the Commission. Additionally, in its Annual Compliance Report, the Postal Service provides public versions of Library References that implement these PRC-approved costing methods. While these public versions do not include line items for each competitive product, they do include a line item for Domestic Competitive Products as a whole.

The Commission also provides substantial opportunity for interested parties to recommend improvements to costing methods. These include strategic rulemaking

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<sup>11</sup> See UPS Comments at 10.

<sup>12</sup> See UPS Comments at 11.

proceedings, e.g., Docket No. RM2011-3 Priorities for Future Data Collection and Analytical Work Relating to Periodic Reporting. One important product of Docket No. RM2011-3 will be updated costing methods for city carrier-street costs that will likely be implemented in the FY 2014 Annual Compliance Report.<sup>13</sup> Interested parties such as UPS and PostCom can also petition the Commission to initiate rulemakings to improve costing methods.<sup>14</sup> That course, however, requires *specific* explanations of shortcomings that can be corrected or improvements that could be made. General assertions, such as described here, would not be sufficient.

### **III. Balancing Disclosure and Oversight**

PSA believes the Commission, generally, has struck an appropriate balance between disclosure and oversight in its rules. This involves combining substantial disclosure of competitive product information (under seal) to the PRC with more limited public disclosure. It is the latter that troubles UPS, and there may be instances where the public disclosure required under Commission rules is not commensurate with that required by publicly-traded companies. If an interested party believes this to be the case, it can petition the Commission to change its rules. That petition should not just describe the information to disclose, but also include appropriate references that demonstrate that publicly traded companies are required to disclose the same or similar information.

### **IV. Capital Commitments and the Competitive Product Fund**

PSA agrees with UPS that competitive products should be charged for the equipment used in the provision of these services.<sup>15</sup> However, UPS is incorrect with respect to the treatment of variable equipment-related costs.<sup>16</sup> PostCom subscribes to

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<sup>13</sup> Docket No. RM2011-3, Postal Service Response to Order No. 1829, October 7, 2013 (Response to Order No. 1829).

<sup>14</sup> Proposals to change an accepted analytical principle applied in the Postal Service's annual periodic reports to the Commission.

<sup>15</sup> UPS Comments at 5-6.

<sup>16</sup> See 39 C.F.R. § 3050.11.

UPS' incorrect description of how these capital costs are handled.<sup>17</sup> These costs, in general, are, in fact, included in the attributable costs of competitive as well as market-dominant products. Specifically, the cost of equipment is charged to products through depreciation. The relevant costing methods are detailed in the Summary Description (at 20-1 through 20-4).

The confusion regarding how equipment costs are distributed to products likely stems from general confusion regarding the operation of the Competitive Product Fund. As UPS notes, last year the Commission established a public inquiry proceeding – Inquiry Concerning Competitive Products Fund (Docket No. PI2013-1) – to “review transfers from the Postal Service Fund to the Competitive Products Fund, the use of amounts from the Competitive Products Fund to prepay competitive products’ future years’ institutional costs, and the calculation and transfer of the assumed federal income tax.”<sup>18</sup> PSA strongly encourages the Commission to proceed quickly in Docket No. PI2013-1 to clarify the operation of the Competitive Product Fund.

## **V. Appropriate Share Requirement**

In arguing that the competitive product appropriate share should be increased, UPS points to the fact that the Postal Service increased competitive product prices by a smaller percentage than market-dominant rates this year. UPS Comments at 6-8. While this is true *this year*, competitive product rates of general applicability have increased more than both the rate of inflation and market-dominant rates.

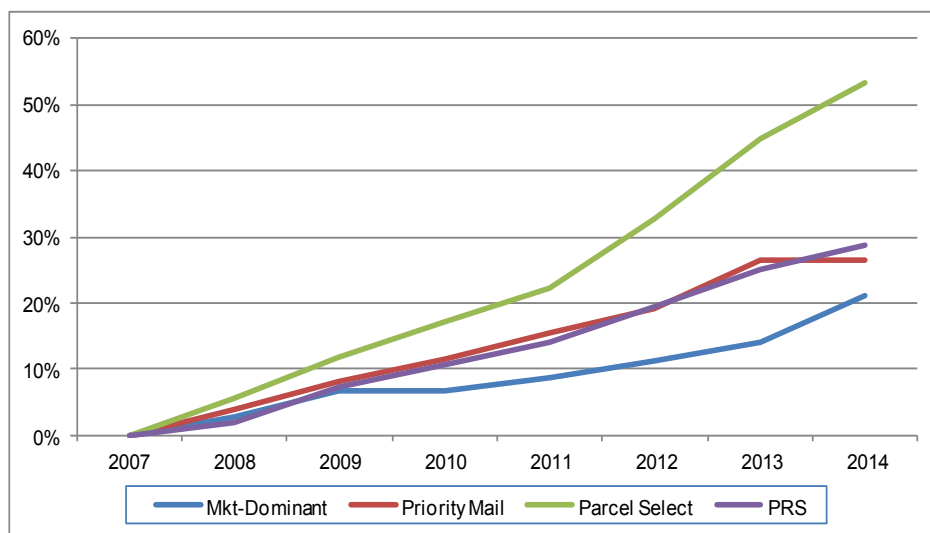
### **Figure 1. Cumulative Overall Rate Increase for Market-Dominant and Select Competitive Products<sup>19</sup>**

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<sup>17</sup> See PostCom comments at 1-2.

<sup>18</sup> Docket No. PI2013-1, Notice Establishing Docket Concerning the Competitive Products Fund (Issued July 19, 2013) at 1.

<sup>19</sup> <http://www.prc.gov/PRC-DOCS/home/CPI.pdf>, at 1; Docket No. R2013-11, United States Postal Service Notice of Further Revisions to the Statement of Altaf Taufique -- Errata, October 29, 2013, at 9; Docket No. CP2008-3, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 08-3),



Given the substantial increases that the Postal Service has implemented and the increases in competitive product contribution that have occurred since enactment of PAEA, it seems clear that the Postal Service has appropriate incentives to increase competitive product contribution, not reduce it. Indeed, competitive products' actual share of institutional costs increased at a more rapid pace than competitive product revenue (as percentage of total revenue) since FY 2008. And this happened despite the transfer of lower-contribution products (e.g., Parcel Select Lightweight) from the market dominant side to the competitive one.<sup>20</sup>

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March 4, 2008, at 1-2; Docket No. CP2009-8, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 08-19), November 12, 2008, at 2-3; Docket No. CP2010-8, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 09-13), September 22, 2009, at 2-3; Docket No. CP2011-26, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 10-4), October 19, 2010, at 2-3; Docket No. CP2012-2, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 11-8), October 18, 2011, at 2-3; Docket No. CP2013-3, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 12-02), September 13, 2012, at 2-3; Docket No. CP2014-5, Decision of the Governors of the United States Postal Service on Changes in Rates and Classes of General Applicability for Competitive Products (Governors' Decision No. 13-02), October 22, 2013, at 2-3.

<sup>20</sup> Competitive products share of total contribution increased by 105 percent. Its share of revenue increased by only 82 percent. See United States Public Cost and Revenue Analysis Reports for 2008 and 2013.

Perhaps, in view of actual experience, there is no need for an appropriate share requirement at all. Parcel growth and the rate increases illustrated above have assured that the Competitive products adequately compensate for their share of the fixed network. Congress addressed this possibility in the PAEA, which permits the Commission to eliminate it if it finds it unnecessary.<sup>21</sup>

Respectfully Submitted,

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<sup>21</sup> See 39 U.S.C §3633(b).